

Auditing Procedures Report

Issued under P.A. 2 of 1968, as amended and P.A. 71 of 1919, as amended

Local Unit of Government Type <input type="checkbox"/> County <input type="checkbox"/> City <input type="checkbox"/> Twp <input type="checkbox"/> Village <input checked="" type="checkbox"/> Other		Local Unit Name No Houghton County Water & Sewage Auth	County Houghton
Fiscal Year End December 31, 2005	Opinion Date May 2, 2006	Date Audit Report Submitted to State May 23, 2006	

We affirm that:

We are certified public accountants licensed to practice in Michigan.

We further affirm the following material, "no" responses have been disclosed in the financial statements, including the notes, or in the Management Letter (report of comments and recommendations).

YES ☒ NO ☐ Check each applicable box below. (See instructions for further detail.)

1. ☒ ☐ All required component units/funds/agencies of the local unit are included in the financial statements and/or disclosed in the reporting entity notes to the financial statements as necessary.
2. ☒ ☐ There are no accumulated deficits in one or more of this unit's unreserved fund balances/unrestricted net assets (P.A. 275 of 1980) or the local unit has not exceeded its budget for expenditures.
3. ☒ ☐ The local unit is in compliance with the Uniform Chart of Accounts issued by the Department of Treasury.
4. ☒ ☐ The local unit has adopted a budget for all required funds.
5. ☒ ☐ A public hearing on the budget was held in accordance with State statute.
6. ☒ ☐ The local unit has not violated the Municipal Finance Act, an order issued under the Emergency Municipal Loan Act, or other guidance as issued by the Local Audit and Finance Division.
7. ☒ ☐ The local unit has not been delinquent in distributing tax revenues that were collected for another taxing unit.
8. ☒ ☐ The local unit only holds deposits/investments that comply with statutory requirements.
9. ☒ ☐ The local unit has no illegal or unauthorized expenditures that came to our attention as defined in the *Bulletin for Audits of Local Units of Government in Michigan*, as revised (see Appendix H of Bulletin).
10. ☒ ☐ There are no indications of defalcation, fraud or embezzlement, which came to our attention during the course of our audit that have not been previously communicated to the Local Audit and Finance Division (LAFD). If there is such activity that has not been communicated, please submit a separate report under separate cover.
11. ☐ ☒ The local unit is free of repeated comments from previous years.
12. ☒ ☐ The audit opinion is UNQUALIFIED.
13. ☒ ☐ The local unit has complied with GASB 34 or GASB 34 as modified by MCGAA Statement #7 and other generally accepted accounting principles (GAAP).
14. ☐ ☒ The board or council approves all invoices prior to payment as required by charter or statute.
15. ☒ ☐ To our knowledge, bank reconciliations that were reviewed were performed timely.

If a local unit of government (authorities and commissions included) is operating within the boundaries of the audited entity and is not included in this or any other audit report, nor do they obtain a stand-alone audit, please enclose the name(s), address(es), and a description(s) of the authority and/or commission.

I, the undersigned, certify that this statement is complete and accurate in all respects.

We have enclosed the following:	Enclosed	Not Required (enter a brief justification)	
Financial Statements	<input checked="" type="checkbox"/>		
The letter of Comments and Recommendations	<input checked="" type="checkbox"/>		
Other (Describe)	<input type="checkbox"/>		
Certified Public Accountant (Firm Name) Jackie A. Aalto, CPA		Telephone Number (906) 337-2727	
Street Address 116 Fifth Street		City Calumet	State MI
Zip 49913			
Authorizing CPA Signature <i>Jackie A. Aalto</i>	Printed Name Jackie A. Aalto	License Number 22394	

**NORTH HOUGHTON COUNTY WATER
AND SEWAGE AUTHORITY**

FINANCIAL REPORT

Year ended December 31, 2005

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INDEPENDENT AUDITOR'S REPORT

Board Members
North Houghton County Water and Sewage Authority
Calumet, Michigan

I have audited the accompanying basic financial statements of the North Houghton County Water and Sewage Authority as of and for the year ended December 31, 2005 as listed in the table of contents. These financial statements are the responsibility of the Authority's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that I plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the North Houghton County Water and Sewage Authority, as of December 31, 2005, and the changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, I have also issued my report dated May 2, 2006 on my consideration of the North Houghton County Water and Sewage Authority's internal control over financial reporting and on my tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of my testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of my audit.

The management's discussion and analysis (identified in the table on contents) is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. I have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, I did not audit the information and express no opinion on it.

My audit was performed for the purpose of forming an opinion on the financial statements that collectively comprise the North Houghton County Water and Sewage Authority's basic financial statements. The supplementary information (identified in the table of contents) is presented for purposes of additional analysis and is not a required part of the basic financial statements. The supplementary information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in my opinion is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Jackie A. Aalto, CPA

Calumet, Michigan
May 2, 2006

North Houghton County Water and Sewage Authority

Management's Discussion and Analysis Year ended December 31, 2005

This section of the annual financial report of the North Houghton County Water and Sewage Authority (the "Authority") presents our discussion and analysis of the entity's financial performance for the year ended December 31, 2005. This discussion should be read in conjunction with the financial statements which follow.

Financial Overview

Net capital assets declined \$255,431 or 2.00 percent. This decrease was primarily due to depreciation expense of \$370,542, which was partially offset by \$140,039 of capital assets purchased. Total assets decreased by \$362,734 or 2.59 percent. This decrease in total assets is primarily the result of the decrease in the aforementioned net capital assets and cash.

Total liabilities declined \$117,334 or 1.38 percent. This is mainly due to the repayment of bonds in the amount of \$119,000. Net assets declined \$245,400 or 4.46 percent.

Operating revenues were \$767,762 a decrease of 3.40 percent from 2004. Operating expenses of \$712,896 were up 1.74 percent from 2004 mainly due to an increase in depreciation expense. Sewer fees from residential and commercial customers in the Authority's service area comprised most of the revenue collected during the year.

The Authority generates cash from sanitary sewage fees based on water usage and a flat monthly service charge charged to its customers. It uses the cash to pay for current operations and to pay the interest and principal on long-term bonds issued to construct the sanitary sewage system. In 2005, net cash decreased \$127,886 or 21.52 percent. A decrease in revenue and the purchase of capital assets contributed to this decrease.

Sewage rates were increased in the beginning of 2005 and again in 2006 to a level which the Authority believes will be sufficient for fund operations and debt service for the coming year. The Authority believes that it is in substantial compliance with all relevant federal and state requirements for the operation of a sanitary sewage system. As such, no additional material investments in the system, and no additional bond indebtedness, are anticipated at this time. A large decrease in water usage would impact the Authority's revenue, which could result in additional rate increases in the future. The Authority is not aware of any circumstances that would cause a significant reduction in water usage. As discussed in Note 7 to the Financial Statements, one customer accounted for 10.77 percent of the Authority's 2005 revenue. Should this one customer significantly lower its water usage, it could have an impact on the financial performance of the Authority and could result in increased rates for the remainder of the customer base. The Authority is not aware of any plans by the customer to significantly alter its water usage at the present time.

Contacting the Authority's Management

This financial report is designed to provide taxpayers, creditors, investors and customers with a general overview of the Authority's finances and to demonstrate the Authority's accountability for the revenues it receives. If you have questions concerning this report please contact Mr. Paul Lehto, Chairman at 25880 Red Jacket Road, Calumet, Michigan 49913.

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

Statement of Net Assets

December 31, 2005

ASSETS		
CURRENT ASSETS:		
Cash	\$ 67,209	
Investments	5,996	
Accounts receivable, net	239,806	
Interest receivable	2,445	
Inventory	8,800	
Prepaid expenses	<u>22,642</u>	\$ 346,898
NONCURRENT ASSETS:		
Restricted Assets:		
Cash	399,075	
Investments	<u>293,679</u>	692,754
Deferred charges		71,233
Capital Assets:		
Land	242,105	
Building and improvements	15,103	
Sewer system	15,288,474	
Machinery, equipment & furniture	310,474	
Vehicles	<u>70,251</u>	
	15,926,407	
Accumulated depreciation	<u>(3,416,006)</u>	<u>12,510,401</u>
Total Assets		<u>13,621,286</u>

The notes to the financial statements are an integral part of this statement.

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

Statement of Net Assets

December 31, 2005

LIABILITIES

CURRENT LIABILITIES:

Accounts payable	6,715	
Accrued expenses	1,880	
Payable from restricted assets:		
Accrued interest	31,113	
Current maturities on revenue bonds	<u>127,000</u>	166,708

NONCURRENT LIABILITIES:

Revenue bonds payable		<u>8,192,000</u>
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Total Liabilities		<u>8,358,708</u>
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NET ASSETS

NET ASSETS:

Invested in capital assets, net of related debt	4,191,401	
Restricted for debt service	661,641	
Unrestricted	<u>409,536</u>	

Total Net Assets		<u>\$ 5,262,578</u>
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The notes to the financial statements are an integral part of this statement.

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

Statement of Revenues, Expenses and Changes in Net Assets

For the year ended December 31, 2005

OPERATING REVENUES:

Sewer fees	\$ 744,059
Other services	9,278
Miscellaneous	<u>14,425</u>

Total Operating Revenues	<u>767,762</u>
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OPERATING EXPENSES:

Salaries, wages & benefits	178,152
Administration	26,775
Supplies & maintenance	72,625
Utilities	33,862
Insurance	28,679
Depreciation & amortization	<u>372,803</u>

Total Operating Expenses	<u>712,896</u>
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Operating Income	<u>54,866</u>
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NONOPERATING REVENUES (EXPENSES):

Gain on disposal of asset	56,009
Interest income	23,658
Interest expense	<u>(379,933)</u>

Total Nonoperating Revenues (Expense)	<u>(300,266)</u>
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Change in Net Assets	(245,400)
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NET ASSETS – Beginning	<u>5,507,978</u>
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NET ASSETS – Ending	<u>\$ 5,262,578</u>
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The notes to the financial statements are an integral part of this statement.

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

Statement of Cash Flows

For the year ended December 31, 2005

CASH FLOWS FROM OPERATING ACTIVITIES

Receipts from customers	\$ 749,361
Payments to employees	(177,674)
Payments to suppliers	<u>(164,654)</u>

Net cash provided (used) by operating activities	<u>407,033</u>
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CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Sale of capital assets	80,938
Purchase of capital assets	(140,039)
Interest paid on capital debt	(380,384)
Principal paid on capital debt	<u>(119,000)</u>

Net cash provided (used) by capital and related financing activities	<u>(558,485)</u>
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CASH FLOWS FROM INVESTING ACTIVITIES

Interest received	<u>23,566</u>
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Decrease in cash	(127,886)
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CASH – Beginning	<u>594,170</u>
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CASH – Ending	<u>\$ 466,284</u>
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RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES

Operating income	\$ 54,866
Adjustments to reconcile operating income to net cash provided (used) by operating activities	
Depreciation and amortization	372,803
Increase in accounts receivable, net	(18,401)
Increase in inventory	(3,887)
Increase in prepaid expenses	(465)
Increase in accounts payable	1,639
Increase in accrued expenses	<u>478</u>

Net cash provided (used) by operating activities	<u>\$ 407,033</u>
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The notes to the financial statements are an integral part of this statement.

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

Notes to Financial Statements

December 31, 2005

Note 1 – Summary of Significant Accounting Policies

A. Reporting Entity

The North Houghton County Water and Sewage Authority was formed in 1983 for the purpose of constructing and making improvements to waste water collection, transmission, and treatment facilities within the service area of the Authority. It operates under a seven member board consisting of two members from the Village of Laurium, one member from Osceola Township, one member from the Village of Calumet and three members from the Charter Township of Calumet. Financial activity of the Authority began during 1986. In 1989, the Authority acquired an existing sewage farm system from the Village of Laurium. It also purchased sewer lines from a local water company in 1990. The Authority completed sewer system improvement projects in 1993, 1995, 2002 and 2003 with funding provided by various sources.

B. Basis of Presentation

The Authority records its financial activity under the proprietary fund type, and within the category of an enterprise fund. The Enterprise Fund accounts for operations: (a) that are financed and operated in a manner similar to private business enterprises where the intent of the governing body is that the costs (expenses, including depreciation) of providing goods or services to the general public on a continuing basis be financed or recovered primarily through user charges; or (b) where the governing body has decided that periodic determination of revenues earned, expenses incurred and/or net income is appropriate for capital maintenance, public policy, management control, accountability, or other purposes.

C. Measurement Focus/Basis of Accounting

Measurement focus refers to what is being measured; basis of accounting refers to when revenues and expenses are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied. The Authority uses the accrual basis of accounting in accordance with generally accepted accounting principles. Under the accrual method, revenues are recognized when they are earned and expenses are recognized when they are incurred. The Authority applies all GASB pronouncements as well as the FASB pronouncements issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements.

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

Notes to Financial Statements

December 31, 2005

D. Cash, Cash Equivalents and Investments

For purposes of the statement of cash flows, demand deposits and short-term investments with maturities of three months or less when acquired are considered to be cash equivalents. In addition, the statement of cash flows includes both restricted and unrestricted cash and cash equivalents. Investments are stated at cost, which approximates market and include U.S. Treasury notes and certificates of deposit with maturities of three months or more. The Authority had no cash equivalents at December 31, 2005.

E. Accounts Receivable

Receivables for sewer fees are shown net of an allowance for uncollectibles, where applicable.

F. Inventory and Prepaid Items

Inventory is valued at the lower of cost or market, using the first-in/first-out (FIFO) method. Inventory consists of expendable material held for consumption. The cost is recorded as an expense at the time the inventory material is consumed.

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items.

G. Restricted Assets – Cash & Investments

Certain resources set aside for enterprise fund revenue bonds and interest payments and equipment replacement are classified as restricted assets on the statement of net assets because their use is limited by the applicable bond covenant or by capital contributors.

H. Capital Assets

Capital assets are valued at historical cost or estimated historical cost if actual historical cost is not available. Donated capital assets are valued at their estimated fair value on the date donated. Improvements to capital assets that add to the value of the asset or materially extend the asset's life are capitalized at cost. Interest costs incurred during construction of assets are also capitalized.

Land with an original cost of \$10,000, and a sewer farm system, with an original cost net of depreciation of \$455,718, were transferred to the Authority from the Village of Laurium on July 11, 1989 and were capitalized by the Authority at net book value. During 1990, the Authority obtained the sewage lines that lie within the Authority's boundaries at a cost of

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

Notes to Financial Statements

December 31, 2005

\$352,501. However, the purchase price did not include the lines within the Villages of Calumet and Laurium since those lines were donated to the Authority. The estimated fair market value of the donated lines has not been determined. Therefore, no related cost basis has been recorded in the financial records of the Authority.

Capital assets, other than land, are depreciated over the estimated useful life of the asset using the straight-line method. The estimated useful lives over which capital assets are being depreciated are as follows:

Sewer System	50 years
Building & Addition	40 years
Vehicles & Equipment	5 years
Furniture	7 years

I. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities; disclosure of contingent assets and liabilities at the date of the financial statements; and the reported amounts of revenues and expenses during the period. Actual results could differ from those estimates.

Note 2 – Cash Deposits

Michigan Compiled Laws, Section 129.91, authorizes the Authority to make deposits and invest in accounts of federally insured banks, credit unions, and savings and loan associations which have an office in Michigan. The Authority is allowed to invest in bonds, securities and other direct obligations of the United States or any agency or instrumentality of the United States; United States government or federal agency obligations; repurchase agreements; bankers' acceptance of United States banks; commercial paper rated within the two highest classifications which mature not more than 270 days after the date of purchase; obligations of the State of Michigan or its political subdivisions which are rated as investment grade; and mutual funds composed of investment vehicles which are legal for direct investment by local units of government in Michigan.

Deposits are in one financial institution in the name of the Authority. The investment policy adopted by the Authority is in accordance with statutory authority.

The Governmental Accounting Standards Board (GASB) Statement No. 3, risk disclosures for the cash deposits at year end are as follows:

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

Notes to Financial Statements

December 31, 2005

Cash & Restricted Cash	
Insured (FDIC)	\$ 100,000
Uninsured	<u>367,604</u>
 Total Cash & Restricted Cash	 <u>\$ 467,604</u>

At year end, the carrying amount of cash and restricted cash was \$466,284.

The Governmental Accounting Standards Board (GASB) Statement No. 3, risk disclosures for investments at year end are as follows:

Investment Type	<u>(1)</u>	<u>(2)</u>	<u>(3)</u>	<u>Carrying Amount</u>
Risk Categorized				
U.S. Treasury notes	\$ 239,675	\$		\$ 239,675
Certificates of deposit	<u>60,000</u>	<u></u>	<u></u>	<u>60,000</u>
 Totals	 <u>\$ 299,675</u>	 <u>\$</u>	 <u>\$</u>	 <u>\$ 299,675</u>

Risk Categories

1. Insured or registered, or securities held by the entity or its agent in the entity's name.
2. Uninsured and unregistered, with the securities held by the counterparty's trust department or agent in the entity's name.
3. Uninsured and unregistered, with the securities held by the counterparty, or by its trust department or agent but not in the entity's name.

Note 3 – Components of Restricted Assets

Restricted assets (cash and investments) as of December 31, 2005 and 2004 are as follows:

	<u>Bond & Interest Redemption Funds</u>	<u>Bond Reserve Funds</u>	<u>Equipment Replacement Fund</u>	<u>Totals</u>
Restricted assets 12/31/04	\$ 239,640	\$ 323,575	\$ 158,920	\$ 722,135
Additions (withdrawals), net	<u>(30,499)</u>	<u>30,500</u>	<u>(29,382)</u>	<u>(29,381)</u>
 Restricted assets 12/31/05	 <u>\$ 209,141</u>	 <u>\$ 354,075</u>	 <u>\$ 129,538</u>	 <u>\$ 692,754</u>

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

Notes to Financial Statements

December 31, 2005

The ordinance authorizing the Sewage Disposal System Revenue Bonds requires that the Authority establish Revenue Bond and Interest Redemption Funds and Bond Reserve Funds in amounts not less than the stated annual requirements. At December 31, 2005 the fund balances are sufficient to satisfy the bond ordinance requirements.

Note 4 – Summary of Capital Assets

A summary of changes in capital assets for the years ended December 31, 2004 and 2005 follows:

	Balance <u>12/31/04</u>	<u>Additions</u>	<u>Deletions</u>	Balance <u>12/31/05</u>
Land	\$ 248,687	\$	\$ (6,582)	\$ 242,105
Building addition	15,103			15,103
Sewer system	15,288,474			15,288,474
Machinery, equipment & furniture	260,524	120,000	(70,050)	310,474
Vehicles	<u>63,598</u>	<u>20,039</u>	<u>(13,386)</u>	<u>70,251</u>
Total Assets	15,876,386	140,039	(90,018)	15,926,407
Accumulated depreciation	<u>(3,110,554)</u>	<u>(370,542)</u>	<u>65,090</u>	<u>(3,416,006)</u>
Net Capital Assets	<u>\$12,765,832</u>	<u>\$ (230,503)</u>	<u>\$ (24,928)</u>	<u>\$12,510,401</u>

Note 5 – Long-Term Debt

Revenue Bonds

The Authority issues bonds where it pledges income derived from the acquired or constructed assets to pay debt service. Revenue bonds outstanding at year end are as follows:

	<u>Wastewater System Projects</u>						<u>Totals</u>
	<u>5%</u>	<u>4.5%</u>	<u>4.5%</u>	<u>4.5%</u>	<u>3.25%</u>	<u>4.5%</u>	
Balance 1/1/05	\$2,275,000	\$ 859,000	\$ 114,000	\$4,032,000	\$ 750,000	\$ 408,000	\$8,438,000
Principal payments	<u>(45,000)</u>	<u>(10,000)</u>	<u>(2,000)</u>	<u>(47,000)</u>	<u>(11,000)</u>	<u>(4,000)</u>	<u>(119,000)</u>
Balance 12/31/05	<u>\$2,230,000</u>	<u>\$ 849,000</u>	<u>\$ 112,000</u>	<u>\$3,985,000</u>	<u>\$ 739,000</u>	<u>\$ 404,000</u>	<u>\$8,319,000</u>

The annual principal payments on the above bonds, payable on June 1 and December 1 of each year, increase incrementally from \$1,000 to \$220,000. Interest is payable on all bond obligations semi-annually on June 1 and December 1.

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

Notes to Financial Statements

December 31, 2005

Revenue bond debt service requirements to maturity are as follows:

<u>Year ending December 31,</u>	<u>Total</u>	<u>Principal</u>	<u>Interest</u>
2005	\$ 501,874	\$ 127,000	\$ 374,874
2007	508,026	139,000	369,026
2008	505,598	143,000	362,598
2009	506,995	151,000	355,995
2010	503,991	155,000	348,991
2011-2015	2,527,349	898,000	1,629,349
2016-2020	2,508,931	1,106,000	1,402,931
2021-2025	2,487,484	1,364,000	1,123,484
2026-2030	2,488,730	1,714,000	774,730
2031-2035	1,626,596	1,208,000	418,596
2036-2040	1,405,446	1,253,000	152,446
2041-2042	<u>62,141</u>	<u>61,000</u>	<u>1,141</u>
	<u>\$15,633,161</u>	<u>\$ 8,319,000</u>	<u>\$7,314,161</u>

Note 6 – Retirement Plan – Defined Benefit

Description of Plan and Plan Assets

The Authority is in an agent multiple-employer statewide, defined benefit pension plan with the Municipal Employees' Retirement System (MERS), administered by a nine member Retirement Board. MERS was established to provide retirement, survivor and disability benefits. The service requirement is computed using credited service at the time of termination of membership multiplied by the sum of 2.0 percent times the final average compensation (FAC). The most recent period for which actuarial data was available was for the fiscal year ended December 31, 2004.

MERS was originally established under Public Act 135 of 1945, and now operates under Public Act 220 of 1996, and the MERS Plan Document, as revised. Pursuant to Act 220, on August 15, 1996, MERS became an independent public non-profit corporation which is an instrumentality of the participating municipalities and courts. Prior to that time MERS was a component unit of the State of Michigan and operated within the Department of Management and Budget. MERS issues a publicly available financial report that includes financial statements and required supplementary information for the system. That report may be obtained by writing to the MERS at 1134 Municipal Way, Lansing, Michigan 48917.

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

Notes to Financial Statements

December 31, 2005

All permanent employees of the Authority are eligible to participate in the plan upon working at least 10 full work days in a given month. As of December 31, 2004, the most recent report available, the Authority had 3 active covered employees, 0 inactive vested members and 0 retirees and beneficiaries. The annual covered payroll at that date totaled \$89,853 and the Authority's total payroll for all employees was \$125,179.

Under the provisions of the plan, pension benefits vest after 10 years of credited service. Participants may elect normal retirement at age 60 with 10 or more years of credited service or early retirement at age 55 with 15 or more years of service, and at age 50 with 25 or more years of service.

Funding Policy

The obligation to contribute to and maintain the system for these employees was established by the Authority's board and does not require employees to contribute to the plan. The Authority is required to contribute at an actuarially determined rate; the rate for 2005 was 8.72%.

Annual Pension Cost

During the fiscal year ended December 31, 2005, the Authority's contributions totaling \$9,848 were made in accordance with contribution requirements determined by an actuarial valuation of the plan as of December 31, 2004. The employer contribution rate has been determined based on the entry age normal actuarial cost method and are based upon the benefit plan(s) adopted by the Authority. Under the entry age normal cost method, the total actuarially-determined contribution requirement is the sum of the normal cost and the payment required to amortize the unfunded accrued liability over the amortization period of 30 years, less the accelerated funding credit, if available. The employer normal cost is, for each employee, the level percentage-of-salary contribution (from entry age to retirement) required each year to accumulate sufficient assets at the member's retirement to pay for his projected benefit. Significant actuarial assumptions used include a long-term investment yield rate of 8% and annual salary increases of 4.5%, plus a percentage based on age-related scale to reflect merit, longevity and promotional salary increases.

The following information has been prepared to provide the information necessary to comply with GASB Statement Numbers 25 and 27. All entries are based on the actuarial methods and assumptions that were used in the December 31, 2004 actuarial valuation to determine the annual employer contribution amounts. The entry age normal actuarial method was used to determine the entries at disclosure.

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

Notes to Financial Statements

December 31, 2005

GASB 25 INFORMATION (as of 12/31/04)

Actuarial Accrued Liability	
Retirees and beneficiaries current receiving benefits	\$ 0
Terminated employees not yet receiving benefits	0
Current employees –	
Accumulated employee contributions including allocated investment income	0
Employer financed	<u>163,561</u>
Total Actuarial Accrued Liability	163,561
Net Assets Available for Benefits at Actuarial Value	<u>130,288</u>
(Market value is \$127,177)	
Unfunded (Overfunded) Actuarial Accrued Liability	33,273

GASB 27 INFORMATION (as of 12/31/04)

Fiscal year beginning	January 1, 2006
Annual Required Contribution (ARC)	8,472
Amortization Factor Used – Underfunded Liabilities (30 years)	0.053632

Note 7 – Economic Dependency – Major Customer

The Authority had one customer in 2005 who accounted for more than 10% of total revenue. The following is information regarding this customer for the year ended December 31, 2005.

	<u>Amount</u>	<u>% of Total</u>
Annual revenue	\$ 767,762	10.77%

Note 8 – Commitments and Contingencies

The Authority receives Federal and State Grants for specific purposes that are subject to review and audit by Federal and State agencies. Such audits could result in a request for reimbursement by the Federal and State agencies for expenditures disallowed under the terms and conditions of the appropriate agency. In the opinion of the Authority's management, such disallowances, if any, will not be significant to the Authority's financial statements.

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

Notes to Financial Statements

December 31, 2005

Note 9 – Risk Management

The Authority is exposed to various risks of loss related to property loss, torts, errors and omissions, employee injuries, as well as medical benefits provided to employees. All risk of loss is covered by commercial insurance. Settled claims for the commercial insurance have not exceeded the amount of insurance coverage in any of the past 3 years.

SUPPLEMENTARY INFORMATION

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY

**Schedule of Revenues and Expenses – Budget to Actual
Operations Only**

For the year ended December 31, 2005

	<u>Original Budget</u>	<u>Final Budget</u>	<u>Actual</u>
OPERATING REVENUES			
Sewer fees	\$ 744,000	\$ 728,000	\$ 744,059
Other income	<u>14,200</u>	<u>98,200</u>	<u>23,703</u>
Total operating revenues	<u>758,200</u>	<u>826,200</u>	<u>767,762</u>
OPERATING EXPENSES			
Salaries, wages and benefits	174,500	174,500	178,152
Administrative expenses	10,000	26,900	26,775
Supplies and maintenance	74,000	83,050	72,625
Utilities	32,000	34,410	33,862
Insurance	33,000	36,000	28,679
Depreciation and amortization	<u>50,000</u>	<u>360,000</u>	<u>372,803</u>
Total operating expenses	<u>373,500</u>	<u>714,860</u>	<u>712,896</u>
OPERATING INCOME	<u>\$ 384,700</u>	<u>\$ 111,340</u>	<u>\$ 54,866</u>

This schedule is for supplemental information. It is prepared to present revenues and expenses related to current operations only and as such does not present the results of operations on the basis of generally accepted accounting principles.

FEDERAL PROGRAMS

NORTH HOUGHTON COUNTY WATER AND SEWAGE AUTHORITY
REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF
FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
GOVERNMENT AUDITING STANDARDS

Board Members
North Houghton County Water and Sewage Authority
Calumet, Michigan

I have audited the accompanying financial statements of the business-type activities of the North Houghton County Water and Sewage Authority, as of and for the year ended December 31, 2005, which collectively comprise the Authority's basic financial statements and have issued my report thereon dated May 2, 2006. I conducted my audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing my audit, I considered the North Houghton County Water and Sewage Authority's internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. However, I noted a certain matter involving the internal control over financial reporting and its operation that I consider to be a reportable condition. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in my judgment, could adversely affect the North Houghton County Water and Sewage Authority's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition is as follows: Because of a limited number of available personnel, it is not always possible to adequately segregate certain incompatible duties so that no one employee has access to both physical assets and the related accounting records, or to all phases of a transaction. Consequently, the possibility exists that unintentional or intentional errors or irregularities could exist and not be promptly detected.

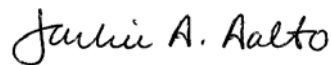
A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, I believe that the reportable condition described above is not a material weakness.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the North Houghton County Water and Sewage Authority's financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of my audit, and accordingly, I do not express such an opinion. The results of my tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

I noted certain matters that I reported to the management of the North Houghton County Water and Sewage Authority in a separate letter dated May 2, 2006

This report is intended solely for the information and use of the board membership, management, federal and state awarding agencies, and, if applicable, pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.



Jackie A. Aalto, CPA

Calumet, Michigan
May 2, 2006

May 2, 2006

Board Members
North Houghton County Water and Sewage Authority
Calumet, Michigan

Dear Board Members:

In planning and performing my audit of the financial statements of North Houghton County Water and Sewage Authority for the year ended December 31, 2005, I considered its internal control in order to determine my auditing procedures for the purpose of expressing my opinion on the financial statements and not to provide assurance on the internal control. I noted certain matters involving the internal control and its operation and other items that came to my attention in the normal conduct of my audit that are presented to assist in improving accounting procedures and controls.

Reportable Condition


- (1) The size of the Authority's administrative staff precludes certain internal controls that would be preferred if it were large enough to provide optimum segregation of duties. This dictates that the Authority Board remains involved in the financial affairs of the Authority to provide oversight and independent review functions. As part of this process I recommend that the Board:
 - a. Adopt a conflict of interest policy.
 - b. Review and update contracts on an annual basis.
 - c. Establish a formal policy to authorize payment of expenses prior to approval to avoid finance charges and to pay budgeted items and payroll.

Other

- (2) The Authority should adopt procedures to verify billings and adjustments made by Michigan-American Water Company.
- (3) At December 31, 2005 the Authority had \$467,604 in cash of which \$367,604 of this amount was uninsured. I recommend that the Authority review its investment policy and procedures to determine if there could be alternative investment strategies that would yield higher investment returns and also allow for FDIC protection.

This report is intended for the information and use of the board members and applicable Federal and State agencies. I will be pleased to discuss this with you at your convenience.

Sincerely,


Jackie A. Aalto, CPA